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Economic Round-up: August 2023

Macro data points from the US, Europe and China and are showing that weakness in manufacturing and services activity still persists. Further conditions in Europe (Eurozone and UK) seem to be deteriorating faster than that in the US. German economy stagnated in Q2, and PMIs have hit rock bottom. To reignite growth, federal government has even announced €32bn tax cut program spread over 4 years. In the US, while initial jobless claims data suggests tightness in labour market still persists, new job openings have reduced. As a result consumer confidence has also taken a hit. Further, weakness in global demand is hampering China's export growth as it fell sharply (most since Covid-19 period) in Jul '23. This is also trickling down to moderation in industrial activity and investment growth. Going ahead, major central banks are likely to take faltering growth into account and slowdown the pace of rate hikes/pause. However, revival in inflationary pressures and Europe, and elevated levels of prices in UK, may push BoE and ECB to hike rates further this month.

Global growth: Global growth continues to remain on shaky grounds as more and more indicators are signalling that real activity is getting dented. While pace of contraction of manufacturing activity seems to have slowed in Eurozone and China, it continues to deteriorate at a faster pace in US and UK. Despite this, Eurozone's manufacturing sector remains worse hit and now services activity has also begun to contract. In UK, real data points (PMIs, mortgage approvals, retail sales) are faltering while nominal data points (tax collections) continue to show a better picture owing to higher levels of inflation. For quarter ending Jun'23, while Germany was the worst performing major economy, India was the fastest growing major economy.

Global Central Banks: In Jul'23, BoE, Fed, and ECB hiked rates by 25bps each. RBA decided to hold rates unchanged in Aug'23 as well. All major central banks are due to announce their decisions in Sep'23. Fed is likely to stand pat in both Sep'23 and Nov'23, as core PCE price index is following Fed's desired trajectory and labour market is also showing signs of cooling down. In case of BoE and ECB, uncertainties persists. In Eurozone, inflation has begun to inch up again in Aug'23 and in UK prices still remain elevated and risks from wage increase persists. However, slowdown in economic activity is exerting pressure on them to opt for a hawkish pause. Analysts expect ECB to hike rates one more time in CY23 (Sep or later) and BoE will have a longer road ahead before it can pause.

Key macro data releases: India's GDP rose by 7.8% in Q1FY24, following 6.1% growth in Q4FY23, thus remaining the fastest growing major economy. Support to growth was provided by private consumption and investment. Sector-wise, financial & real estate sector, trade, transport etc, and public administration and defence spending provided major boost to GDP in Q1.

On the industrial production side, core sector output in Jul'23 accelerated by 8%, slowing a tad from 8.3% increase in Jun'23. Moderation was mainly on account of slowing output in sectors like steel, cement, and petroleum refinery products.

CPI inflation rose way more than our expectation of 5.8% to 7.44% in Jul'23 from 4.8% in May'23, on YoY basis. The upside surprise was on account of 702bps jump in food inflation, led by 37.3% jump in vegetable inflation. Barring eggs and meat, all components of food noted sharp pickup. Core CPI (excl. food and fuel) has moderated to 5%. Considerable drop was visible for clothing and footwear (5.6% in Jul'23 from 6.2% in Jun'23, on YoY basis).

Global developments

Global growth on shaky ground

Global PMIs show that both manufacturing activity remains weak in across regions-US, Europe, Asia (China, Japan, and Australia). However, the pace of worsening varies. While in US, UK and Australia, pace of contraction fastened in Aug'23, it appears to be slowing a tad in Germany and France. In case of services sector activity, barring Japan (steady expansion), all others registered further slowdown in Aug'23.

In the US, recent slowdown in manufacturing and service activity comes at a time when GDP has already begun showing signs of stress from Q2CY23 onwards. Second estimates show that real GDP growth was revised substantially down to 2.1%, from 2.4% as per advanced estimate, and is similar to 2% growth registered in Q1. The downgrade was mainly owing to lesser than previously estimated inventories and non-residential investments. In Q3 (till date) also, ISM manufacturing PMI (Jul-Aug'23) is expected to show similar deterioration (46.7) as was seen in Q2 (46.7). Services sector activity is also reeling under pressure with ISM PMI estimated decline in Aug'23 from Jul'23. This is also beginning to show impact on labour market. The 4-week moving average for initial jobless claims for the week ending 26 Aug'23 inched up to 237.5k from 237.25k. Job openings in Jul'23 (8.83mn) had fallen to their lowest level since Mar'21, and were down from 9.17mn in Jun'23. Weakness in labour market is also impacting consumer confidence. Conference board consumer sentiment index for Aug'23 fell to 106.1 from a downwardly revised print of 114 in Jul'23. Six-month ahead outlook for growth and labour market dropped further.

Eurozone's (EZ) flash manufacturing PMIs indicate that decline in activity may have bottomed out as PMI for Aug'23 reflect slowdown in pace of contraction. In Aug'23, flash manufacturing PMI rose to 43.7 from 42.7 in Jul'23, led by moderation in decline seen in both Germany (39.1 versus 38.8) and France (46.4 versus 45.1). Dragged by muted economic environment, services sector in Eurozone (48.3 in Aug'23 versus 50.9 in Jul'23) and Germany (47.3 versus 52.3) also slipped into contraction in Aug'23, following expansion seen until Jul'23. German economy stagnated in Q2 (0% growth), unable to revive following the winter recession (Q1CY23: -0.1%; Q4CY22: -0.4%). As a result, its Federal government has recently announced a fiscal stimulus package of €32bn, spread over 4 years. This includes measures like corporate tax cuts and subsidies to cover 15% of cost of companies' green investments. In the first year, cost to exchequer from reduction in tax rates is estimated to be €7bn. French economy on the other hand, performed relatively better in Q2, as GDP numbers confirmed 0.5% (QoQ) growth following flat growth (0%) in Q1. However, outlook remains bleak as inflation is beginning to pick up again and ECB's policy rates remain elevated.

China's official manufacturing PMI shows that activity in Aug'23 continued to contract, although at a slower pace (49.7 in Aug'23 versus 49.3 in Jul'23). While new export orders reverted back to expansionary zone (a first in 5 months), the trend might be transitory as global demand continues to weaken (led by Europe). Non-official PMI eased to 51 in Aug'23 from 51.5 in Jul'23, dragged by services sector. As pent-up demand in China fades, retails sales growth decelerated to 2.5% in Jul'23 from 3.1% in Jun'23. Weakening economic momentum from industrial production (3.7% in Jul'23 versus 4.4% in Jun'23), exports (-14.5% drop in Jul'23—sharpest since Covid-19 outbreak) and investment (FAI growth at 3.4% between Jan-Jul'23 versus 3.8% in H1CY23), is exerting pressure on consumer spending and services sector growth. This has strengthened the case for more government stimulus to boost growth. Recently, Chinese government had announced cut in stamp duty on stock trading and has approved guidelines to improve access for first home mortgages under affordable housing.

RBI credit policy

In a unanimous decision, MPC members decided to keep the policy rates on hold for the 3rd consecutive time, and with this, repo rate remains unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. With a vote of 5-1, RBI also continued with its stance of "withdrawal of accommodation". Governor noted that given the uncertainty in inflation outlook, RBI remains prepared to act accordingly 'if situation warrants'. He insisted that MPC remains focused and committed on ensuring that inflation aligns with the target level, while supporting growth. Today's statement had a hawkish tilt with inflation projection revised upwards and we therefore expect no rate cut in FY24. The earliest possibly of rate cut has now shifted to Q1FY25, with likelihood of a possible rate hike also on the table.

For FY24, RBI revised its inflation projection upwards by 30bps to 5.4% from 5.1% in Jun'23. This was largely on account of sharp rise in the forecasts of Q2FY24 revised up 6.2% from 5.2% earlier, higher projection for Q3 (5.7% versus 5.4%). Estimates for Q4 were retained at 5.2%. Notably, inflation for Q1FY25 has been projected at 5.2%. RBI retained its GDP forecast for FY24 at 6.5%, unchanged from Jun'23 projections as aggregate demand conditions continue to remain buoyant. Q1FY25 GDP growth is projected at 6.6%.

Global central bank decisions

In line with market expectations, US Fed had hiked rates by 25bps in its Jul'23 policy meeting, thus taking the benchmark rate to 22-year high of 5.25-5.5%. Following this, Fed Chair in his Jackson Hole speech reaffirmed the need to keep monetary policy tight as inflation continues to remain above Fed's targeted level. Fed Chair even signalled that the central bank will keep rates elevated for as long as necessary and may even hike rates if need arises. However, recent weakness in macro data (GDP growth, consumer confidence, PMIs) signals that Fed will refrain from raising rates in its Sep'23 meeting.

Bank of England (BoE) also in its Aug'23 policy meeting decided to lift the key policy rate by 25bps to 5.25% from 5% earlier. The decision was not unanimous (6-3 split decision). While 6 members voted for 25bps hike, 2 members were in favour of 50bps hike and 1 member in favour of keeping rates unchanged. For its Sep'23 meeting, analyst expectations are split between 25bps rate hike and a hawkish pause. On one hand, inflation has come down in Jul'23 (6.8% from 7.9% in Jun'23) but it still remains at elevated levels, this along with wage pressures, make the case for rate hike. On the other hand, slowdown in real economic activity (drop in manufacturing PMI, mortgage approvals, retail sales) can push BoE towards a pause.

ECB in its Jul'23 meeting raised its key policy rate by another 25bps to 3.75%. As major economies within the Eurozone are showing signs of slowdown (downturn in manufacturing and services PMIs, stagnation in German economy), some analysts are expecting ECB to pause in Sep'23. However, ECB President at Jackson Hole event recently reiterated that rates will have to remain elevated for long, as inflation continues to run above central bank's targeted level. Further, with latest CPI data coming in for major economies (Germany, France), inflation is again beginning to pick up in Aug'23, which is likely to put pressure on ECB to hike rates. Currently there stands 60% probability of rate hike in Sep'23.

Bank of Japan continues to keep its policy rate unchanged at (-) 0.1%, but had recently surprised the markets by tweaking the Yield Curve Control (YCC) curve. The bank stated that it will continue to allow 10Y bond yield (0% target) to trade between +/- 0.5% but will use these upper/lower bound limits as "references" instead of "rigid limits". BoJ will now not intervene as long as the 10Y bond yield remains "below 1%" mark. In recent weeks, talks of timing of scaling back its massive monetary stimulus have increased. Although BoJ's Governor has reiterated that this year no scaling back will be done. The central bank wants to achieve 2% inflation target on a durable basis, led by domestic consumption rather than loose monetary policy. The bank wants to monitor ability of firms to increase wages even next year, before scaling back. Initially, negative yield could be done away with a measure of scaling back the stimulus.

Special studies

BoB Forecasts of kharif production

Past data indicates that over 90% of kharif sowing is completed by August end. Based on this data point we have estimated the kharif production for this year under certain assumptions, and the picture emerging from this analysis is mixed. A pickup in rice sowing has ensured that rice output is likely to improve marginally this year. This will be a relief as cereals inflation has been a concern in the last few months. On the other hand, production of pulses is estimated to fall as it looks unlikely that the sowing area will change significantly going ahead. In case of oilseeds and cash crops such as sugarcane, production is estimated to be only slightly higher than last year. This has also been reflected in domestic prices, with prices of almost all major commodities witnessing upward momentum. Swift supply side interventions from the government have helped in keeping price pressures from spiralling, but risks remain from de-anchoring of inflation expectations. We continue to maintain our inflation forecast for FY24 at 5.5%, but do see upside risks.

Rainfall deficit increasing which is a concern and adds to negative sentiment:

The monsoon this year has played truant and after a rather satisfying month in July dropped off in August with the overall cumulative deficit now being at around 10% of LPA. The monsoon pattern has been quite erratic and while 10 met divisions have recorded deficient rainfall so far, the spread across districts has been uneven. Heavy rains in Jul'23 have been followed by arid conditions in Aug'23, and hence the crop prospects could have been affected. It is assumed here that there has been no adverse effects as that can be known only after a survey is undertaken.

Stocks of rice with the FCI steady, but lower than in the past:

What poses a concern is that though rice stocks are comfortably above the buffer norms, it is still the lowest in past 5 years. The level of 24.3mn tonnes though higher than the buffer stock norms is the lowest in the last 5 years as of August 2023. The Centre has tried to ensure that supplies remain comfortable by invoking a series of measures. These include imposing a ban on export of non-basmati white rice with effect from 20 Jul 2023, not allowing exports of basmati rice below the value of US$1,200 per tonne and imposing a 20% export duty on parboiled rice. But as of now, the domestic prices are reflective of these ongoing tensions.

What signals on output come from market prices?

Prices of kharif crops do indicate to an extent output expectations. The table below gives the average domestic monthly prices of some of the leading kharif crops for the past few months.

The price picture show considerable degree of strain. We have tried to see how prices of different crops have fared both compared to last year and also since the onset of monsoon. One thing which clearly emerges is that prices have broadly moved in tandem with production. We have used the CMIE polled prices of commodities, which can be used as domestic prices and in turn gives a forward signal to capture the price-production dynamics. Following points stand out:

- For pulses, there is a clear upward pressure in prices across all categories. Within this:
  - The sharpest increase is visible in case of Tur, for which prices have increased by 37.1% in Aug'23 on a YoY basis. Since May'23 i.e. the onset of monsoon, prices have increased by 14.7%. Even the sown area till 25 Aug 2023 at 4.36 mn hectare is lower compared with 4.62 mn hectare seen last year. Further, with close to 97% sowing already completed, any sharp improvement in acreage is unlikely. This in turn might result in further increase in prices.
  - For urad and moong, considerable increase in market prices is visible, showing that the price rise in pulses is broad based. For these two categories production drop is expected to be the sharpest in 2023-24.
- In case of rice as well, price has risen considerably, noting a 9.1% jump on YoY basis and a 7% increase since the onset of monsoon. Here, production is still expected to be moderately better compared to last year, as sowing till date has been higher at 38.4mn hectare compared to 36.76 in the same period of last year. The higher prices can be linked more to the existing stocks in the market. In fact, any trade intervention by the government in the form of ban on exports tends to generate negative sentiment on prices which then continue to increase. It can be expected that once the new crop comes in, prices would mean revert.
- For other cereals, such as maize and Jowar, despite an expected improvement in production, prices have seen an increase primarily led by demand push inflation as well as the end of season syndrome where prices increase before the new crop comes in. Oilseeds are another area of concern where barring soybean, prices have increased across all categories. On production front, sowing has only moderated for Groundnut. However, for all other crops it remained broadly stable.

There has been some concern on availability of food products for domestic consumption due to lower production. Uneven rainfall and the threat of El-Nino has only compounded these concerns. As a result, the government has preemptively announced measures to improve domestic accessibility. These include:

- Restrictions have been placed on some categories of wheat and rice exports.
- Sugar exports too have been capped.
- On the other hand, to meet domestic demand, imports of pulses has increased by more than 100% in both value as well as volume terms in Q1FY24. Most of these imports have come from Myanmar and Australia. Small African countries such as Mozambique and Sudan have also been supplying pulses to meet India's consumption demand for the same.

Under these conditions how would the kharif crop fare?

It has been seen that the end of August accounts for around 94% to 99% of final area under cultivation for all major crops as per the trends seen in the last 3 years. It is hence possible to conjecture the final crop on the basis of the area under cultivation based on this assumption. While the monsoon formally ends in September, there could be still some sowing taking place in September. However, past trends do indicate that the sowing has almost been completed for most crops which is a reasonable assumption to make here in this exercise.

The forecasts of crop output for various kharif products has been presented in Table 2. The trends in final area under cultivation for all crops has been extrapolated based on the progress made till August end (as of 25 Aug 2023). Further, the productivity levels have been reckoned for these crops based on past trends and juxtaposed on the current data set to have an idea of possible crop output numbers.

It is assumed that there would be no crop damages either due to excess rainfall or other extraneous factors at the time of harvest. Further, the output ranges are on the basis of static or reasonable improvement in productivity for some crops. It has been seen that the productivity levels have been range bound in the past and hence have been averaged out. For certain crops there are assumptions made on limited productivity improvements based on market information. Based on these assumptions we project output levels for the kharif crops. The ranges that are provided give the conservative and optimistic limits.

Following observations can be made:

- Total foodgrains production in the country is expected to be higher by around 1.2-3.1%.
- The increase in foodgrains production is led by cereals, especially rice.
- Rice production is expected to increase to 112.7-114.2 mn tonnes. This represents an increase of about 2.4-3.8% over last year.
- Production of coarse cereals is also expected to be higher. Within this, production of Bajra and Jowar is likely to see the highest increase in the range of 5-14%. Maize production, which has been showing positive sowing momentum is also expected to be higher by around 2-6%.
- For pulses, the progress in sowing has been much lower than last year and it remains a key concern area. As of 25 Aug 2023, kharif sowing for pulses was lower by 8.3% over the same period last year. Based on this, we estimate pulses production to be lower by ~12% which is the worst case scenario. A more optimistic scenario accounting for higher productivity, places overall production for pulses about 7% lower than last year.
    - Within major pulses, production of urad is expected to show the maximum decline.
    - Moong production is estimated to be 11-15% lower this year.
    - Output of tur, which is most consumed in India, is likely to be lower by 5-6%. It is to be noted here that since tur is a rain intensive crop, its production could be even lower due to deficient rains in key cultivating states.
- Production of oilseeds is likely to see a moderate increase to 26-27 mn tonnes. Within this, while output of soybean, Sesamum and castor seeds is expected to be higher, production of groundnut is likely to be lower than last year.
- For cash crops, cotton sowing has been trailing the levels of last year. We expect this deficit to reflect in the production numbers as well. This holds true for jute as well.

- On the other hand, output for sugarcane is likely to improve marginally by ~1%.

So, what is the inflation outlook?

The price-production dynamics are likely to have an impact on India's inflation trajectory. In Aug'23 prices are showing some degree of moderation, especially vegetables, which imparted a considerable shock to the Jul'23 CPI print. Government's supply side interventions have played out well in this regard. However, what poses a concern is the strain from lower production may seep into inflation expectations.

Our inflation forecast for FY24, in the base case stands at 5.5%, with Q2 at 6.7%, Q3 at 5.9% and Q4 at 4.9%. Risks remain tilted to the upside. However, major deviation is not anticipated as in previous episodes (FY16, FY17) where pulses inflation have been in double digits, headline inflation was comforted by a range bound core, which in the current scenario seems more favourable.

Update on banking business in India as of August 2023

The banking sector has been witness to two significant developments when it comes to business.

- The withdrawal of the Rs 2000 note and subsequent sharp increase in deposits with banks.
- Merger of HDFC Bank with HDFC Limited which has changed the size of the both deposits and credit. The merger took effect from July 14th.

Against this background, three aspects can be looked at. For maintaining comparability, the effect of the merger has been excluded.

Growth in deposits

- Growth in deposits has been sharper in the current financial year for the first 4 months and 1 fortnight of August.
- RBI has stated that by July 31, around Rs 3.14 lkh crore of 2000 rupee notes have come back of which 87% was deposited in banks. Hence around Rs 2.73 lakh crore has been added to deposits on this score. Therefore out of the Rs 10.44 lakh crore of incremental deposits since March, around 26% has come through this mode. This has been beneficial for banks which would otherwise have been under pressure for garnering deposits.
- However, even if this is excluded, incremental deposits have been much higher at Rs 7.71 lakh cr as against Rs 4.83 lakh crore last year during the same period. Clearly the higher deposit rates offered by banks has helped to shore up funds for banks.

Growth in credit

- Growth in credit has just about been the same as that last year.
- Lower growth in credit relative to deposits has helped to create a surplus in liquidity which has partly been absorbed by the RBI through the ICRR.
- Incremental investments were Rs 3.86 lakh crore against Rs 3.43 lakh crore last year.

- It can be said that in the absence of the ICRR, liquidity would have been much more comfortable as growth in credit has yet to pick up and may be expected from September onwards depending on the state of the economy.

Movement in Interest rate

- Interest rates have tended to moderate during the course of the year with yields on securities coming down.
- However, ever since the inflation number for July came in at 7.4% and the RBI has been emphasizing the inflation factor, the market has been nervous with yields moving up from less than 7.10% to the current levels. The Fed position on rates has also been influencing the movement in bond yields along with the messages being sent indirectly by the RBI which includes the ICRR.
- The weighted average deposit rate has increased in June after falling in the first two months of the year. The WALR however has shown a fluctuating tendency but stands lower than in March.

The curry problem explained: After tomatoes, it is onions now

After witnessing a sharp rise in the prices of tomatoes across the country, the related commodity that has followed suit is onions. In a period of 2 months, the price of onions had increased from Rs 23.5/kg at the All India retail level to Rs 31.4/kg as on 21st August. This led to the government putting a 40% tax on export of onions.

Onions are a necessity in the Indian household being a staple and often is used along with tomatoes in the kitchen. Tomato prices had peaked on 6th August at Rs 140 but came down to Rs 82 by 21st. The cycle has turned around with supplies improving in the last week or so. The action on onions can be seen more as a pre-emptive measure in the wake of rising prices.

The production cycle

The estimated production of onions during 2022-23 based on a PIB release is around 31.8mn tonnes, which is marginally higher than the 31.7mn tonne mark of 2021-22.

Onion is grown in almost all the states in the country. However, Maharashtra is the leading producer, with share of around 43%, followed by Madhya Pradesh (16%), and Karnataka & Gujarat contributing around 9% of output.

The cropping pattern is interesting. It is harvested thrice a year, with cropping seasons reported during Kharif (October-December), late Kharif (January-March) and Rabi (end-March to May).

The harvest of Rabi is most important as it contributes nearly 70-75% of output and is made available for a longer period of time till the Kharif output comes in. The shelf life of Rabi harvest is highest and store worthy, whereas the Kharif and Late Kharif crop is for direct consumption and not store worthy. The timing of the harvest of onion across the country provides regular supply of fresh/stored onion all over the year.

As the Rabi crop is made available for the months till October, any news of the sowing and possible harvesting pattern of the kharif crop tends to lead to price volatility. Onion crops gets affected by both absence and excessive rainfall and hence tends to be more vulnerable to monsoons than other horticulture crops. As onions are stored by farmers and traders to earn higher prices towards the beginning of the next harvest i.e. October, excess rains tend to also damage the stored crop.

The export ban

The government has been using trade policy as a way of controlling supplies and prices of such essential commodities. The present export tax of 40% will make them less competitive in global markets; and hence to this extent will ensure that the supplies remain robust within the country hence taming prices.

On the other side, the onion dealers believe that such a move will lead to excess supplies in the market leading to prices falling sharply which in turn will affect the farmers' income as well as future cropping as they may choose to try other crops.

Total exports of onions were around 8% of total production in FY23. By curbing exports, the domestic supply can be augmented to this extent. Main importers are SAARC countries, Gulf nations and SE Asia like Malaysia and Indonesia. As India is the second largest producer of onions (after China), any cut in exports has potential to push up global prices.

How does it look like going ahead?

Two important factors will be at work from now on. First, the state of the Kharif crop will be important. Excessive rains in the month of July had affected some part of the sowing which will be known more towards October or so when the harvest takes place. Also, states like Maharashtra have also had dry conditions in August which needs to be evaluated. Rising prices are normally an indicator of market conjectures of the crop. Therefore, it does look like that there could be problems here.

Second, government's step can be seen more like a precautionary measure to ensure that supplies are regularized given that exports have some effect in terms of lowering available stock in the country. But such steps do also have a tendency to reinforce the scarcity factor and push up prices further as the policy would buttress the market belief on the crop prospects.

Presently, it does not look like that there is any profiteering is being done at the retail end as the premium over the wholesale prices has been around 33% in the period April-August. This is slightly higher than an average of 29-30% witnessed in the last few years.

How important is onion from the inflation standpoint?

Onions have a weight of 0.64% in the CPI, which is around 10% of the overall weight of vegetables (6.0%). Combined with tomato the weight is 1.21%, and hence the government is worried that overall inflation will be impacted sharply by this measure. Intuitively, every 10% increase in prices of these curry products will lead to an increase of 0.12% in the CPI.

In case of WPI onions have a lower weight of 0.16% and tomato 0.28%, with vegetables having a weight of 1.87%.

Therefore, onions would have a higher impact on CPI and could potentially come in the way of monetary policy going ahead.

India’s crude import-story so far

Russia meets a large portion of India’s ever growing demand for crude oil. It remains one of the biggest suppliers and in Q1FY24. Its share in total imports has risen remarkably. Back in Q1FY23, against the backdrop of the Russia-Ukraine conflict, India was able to access crude oil at much discounted rates from Russia. Interestingly, this year in Q1FY24 while India continues to imports crude oil at discounted rate from Russia compared with other countries; the premium has actually gone down relative to last year.

Import of Crude in the Q1FY24 vis-à-vis Q1FY23

Across the globe, India remains one of the top importers of crude oil due to high demand. In Q1FY23, India had imported over US$ 10.8bn worth of crude oil from Iraq, much higher compared to other countries. It was during this time the Russia-Ukraine conflict was on the rise and only US$ 4.6bn of crude oil was imported from Russia. In comparison to Q1FY23, the picture has turned completely in Q1FY24 where Russia became the most important source for import of crude oil. The figure stand at US$ 12.4bn which is a sharp jump (3-times) from the same period last year.

With respect to cost, the average price of international crude in Q1FY23 stood at US$ 112/bbl.

Amongst other countries, Malaysia was providing crude oil to India at US$131/bbl against the price of US$ 99/bbl charged by Russia. This price is not only cheaper than other countries but far lower than the international crude oil price too. On the other hand, in Q1FY24, the average price of international crude oil stood at US$ 77.7/bbl. During this period, UAE and Saudi Arabia were able provide crude oil at much higher rates of US$ 86/bbl and US$ 85/bbl respectively. Notably, Russia has been providing crude oil at a much discounted rates than its global counterparts at US$ 69/bbl.

It is also interesting to note that in Q1FY23, the premium rate (difference between average international crude price and that charged by Russia), for crude oil per barrel was at US$ 12.6. On the other hand, this premium amount has fallen down to US$ 8.8/bbl in Q1FY24, narrowing the gap between the two prices.

Financial Performance of Companies: Q1-FY24

The overall performance of companies in the first quarter of FY24 has shown a different picture from that seen in FY23. This time, there has been a sharp pick-up in growth in profits while growth in sales has slowed down substantially. Hence, the picture is different from the preceding three quarters where turnover growth was impressive but profits were depressed due to higher input costs.

Q1 had been characterized by growth in industry by 4.5% (12.8% in Q1-FY23), composite PMI averaging 60.9 (58.0), credit growth of 18.1% (12.3%), inflation 4.6% (7.3%), and exports (-) 9.3% (+3.3%).

There has been a sharp slowdown in growth in net sales to 2.8% compared with 40.2% last year during the same quarter. The moderation in growth goes along with the fact that the IIP had witnessed lower growth this quarter on a high base of last year. But what is significant is that even though the PMIs have been very impressive the same has not been reflected in the sales growth numbers. The lower growth in sales was accompanied also with a more than commensurate fall in expenses, which was -0.6%. This in turn helped in maintaining growth in operating profit at 18.6%. Lower commodity prices globally did help to put a check on expenses on raw materials for most industries. Higher growth in operating profit as well as profit after tax was witnessed in this quarter.

The performance has been skewed by the inclusion of the BFSI sector which includes banks, finance companies and insurance. If these are excluded there is a contrast witnessed. Sales have fallen by 2.5% while profit growth has been maintained at 34.4% with operating costs also falling at a higher rate. However, the general trend remains unchanged of sales being downbeat with profits improving.

Interest costs increased sharply by 12.5% which was higher than that of 9.8% in 2022. The higher growth in profits has worked for these sample companies as the interest cover has improved to 6.82 from 6.0 last year. Hence higher interest rates has not impacted the debt service capability as profits have been robust this quarter.

Size-wise performance

The sample is dominated by the larger companies which have annual sales of above Rs 250 crore (Rs 62.5 crore in Q1-FY24). While the sample is biased towards the non-MSME companies, a trait that comes across all groups of companies is that, there has been an improvement in net profits for the MSMEs which moved from negative to positive in Q1-FY24. But, growth in sales was negative across the board. In case of micro and small units the decline in sales was a continuation of what was witnessed in Q1-FY23. Therefore, there is some concern on the topline growth

It may be recollected here that the RBI started raising rates in May 2022 and hence the major impact on interest cost was felt from the second quarter onwards. In Q1-FY24 there was a turnaround for the MSME segments with improved profitability.41

Interest cover

During this period it was observed that the RBI had kept the repo rate unchanged at 6.5% in the two policies in April and June. Hence, there was no institutional change made in interest rates. Banks however did take calls on their interest rates based on their requirements on both the deposits and credit sides. For the banking system as a whole, the weighted average lending rate (WALR) on fresh loans varied over the months. From 9.32% in March, it came down to 9.08% in April. But it rose to 9.27% in May and declined again to 9.20% in June. Hence, the rates were lower than those at the end of the last financial year.

The sample companies witnessed continued improvement in the interest cover ratio.

- Barring finance and telecom all other sectors had an IR of above 2.
- Realty, textiles and agro products had a ratio of 2-3.
- 17 of the 32 sectors had IR of above 5.
- 13 witnessed an improvement in Q1-FY24.

Industry-wise performance

Overview of growth in sales and net profits of various industries in the first quarter of this year over that of last year shows that performance of various industries vary significantly for this quarter. **In general:**

- Banks and infrastructure oriented industries have done very well this quarter. This includes construction materials. However for iron and steel and capital goods, profit growth was negative even as sales growth was high as demand emanated mainly from the government capex plans.
- Services have done well such as retail and hospitality. Media has witnessed growth in sales though profits have been under pressure.
- On the consumer side the performance was mixed. FMCG did well in sales and profit though durables witnessed negative growth in profits and sales. Agri products did reasonably well with growth of 0-10% in both the variables. Automobile sector witnessed high growth in both sales and profits.

The developments in various industries as well the reasons for the performance can be found in our detailed report.

Concluding remarks

The overall performance has been mixed with industries performing in a differential manner. While sales growth has been depressed, profits have improved at the aggregate level. Yet around 12 industries have witnessed lower growth in net profit relative to last year. Clearly the performance is not broad-based. The impact of higher input costs that were not passed on in the previous two years has exerted pressure on growth in profits.

Q2 is more likely to be similar and given that most of the festivals have been delayed, the expected demand is likely to be more visible in the third quarter though September may witness some momentum. Demand will be affected by the final performance of agriculture which will drive demand. Urban demand should be steady though the push received from pent-up phenomenon of last year will be missing. At the statistical level, decline in profit in the last three quarters of FY23 should provide a favourable base effect in Q2

How has state capex performed in Q1FY24?

Capital expenditure by the government continues to remain the key driver of economic growth in the last few years. The Central government has progressively increased its capital expenditure as it aims to spur investment and growth. In the Union Budget this year, the capex allotment by the Centre was increased to Rs 10 lakh crores or 3.3% of GDP. The move was aimed at kick starting a virtuous cycle of investment in the economy, nudging private investment in the process. In Q1FY24, Centre's capex spending has been robust at Rs 2.78 lakh crores which is 27.8% of FY24BE. This is higher than 23.4% in the same period last year. On a YoY basis, Centre's capex spending increased by 59.1% in Q1FY24.

Another important aspect of the overall investment in the economy is states' spending on capex. The picture remains quite somber. Based on data available for a total of 23 states, out of a budgeted capital expenditure of Rs 7.98 lakh crores, actual capex is only Rs 1.06 lakh crores, which is just 13.3% of the budgeted amount. However, when compared with the same period last year, states' capex spending has improved. In Q1FY23, state capex stood at Rs 61,222 crore or just 9% of FY23BE. On a YoY basis, states' capex has increased by a sharp 73.9% in Q1FY24

Out of a total of 23 states, a majority showed an improvement in capex spending this year, when compared with the same period last year. In fact, only 5 states, namely, Chhattisgarh, Gujarat, Himachal Pradesh, Karnataka and Maharashtra has capex spending lower than last year.

In terms of state wise performance, the following observations can be made:

- Andhra Pradesh has been at the forefront of capex spending, achieving 40.8% of its total budgeted capex spending in Q1FY24 itself. This is much higher than the corresponding figure in Q1FY23 which stood at 7%. It must be noted that Andhra Pradesh had been lagging in terms of capex spending in FY23, and achieved only 23.1% of its total target.
- There are four states which have achieved more than 20% of their budgeted capex in Q1FY24. These are: Telangana, Madhya Pradesh, Kerala and Nagaland. For each of these, capex spending has been higher this year, compared with last year.
- The next 3 states, Rajasthan, Gujarat and Haryana have achieved more than 15% of their target, which is also higher than the corresponding period last year.
- For other states, capex spending has been lower than the sample average which stands at 13.7%.
- Amongst major states, performance of Karnataka and Maharashtra remains worrisome.
- Karnataka had performed exceptionally well last year in terms of capex spending, achieving ~130% of its FY23 target. This year however, capex spending has only been 3.4% of the target in Q1, which is also lower than 10.3% achieved in the same period last year. Limits on spending imposed due to elections in the state explain this. With the formation of a new government, capex spending is likely to improve in coming months.
- For Maharashtra as well, capex spending in Q1FY24 is only at 4.8% compared with 9.3% in the same period last year.
- Uttar Pradesh which account for ~18% of total budgeted capex of the 23 states, has only achieved 6.8% of its capex target.

Market borrowings:

Apart from revenues, states rely heavily on market borrowings to fund their capex spends. Grants from Centre also form an integral part of states' finances. In this regard, we have compared the market borrowings of all states in this year (up to 8 Aug 2023) with the same period last year. This helped us understand whether market borrowings influenced the capex decisions by different states.

The following points stand out:

- State borrowings this year have been higher at Rs. 2.46 lakh crores, compared with Rs. 1.97 lakh crores in the same period last year, rising by 24.5% on a YoY basis.
- In both the years, the actual borrowings have been lower than the amount indicated in the auction calendar.
- As a % of the amount notified in the auction calendar, market borrowings by states has been higher this year at 82.2% compared with 70.2% in the same period last year.
- Performance amongst states diverges. Amongst major states, states which have borrowed in excess of their planned borrowings as per the auction calendar include: Andhra Pradesh, Tamil Nadu, Kerala, Telangana and Rajasthan. It is interesting to note that capex spending in some of these states has also been on the higher side. This is true for Andhra Pradesh, Telangana, and Kerala and to some extent Rajasthan.
- On the other hand, borrowings of states such as Bihar and Punjab has been more or less in line with what had been indicated in the auction calendar.
- For Maharashtra, market borrowings have remained almost unchanged at ~Rs 30,000 crore in both the periods.

Apart from this, in the Union Budget for FY24, the Central government extended the scheme for providing Special Assistance to States for Capital Investment this year as well. Under this scheme, Centre provides financial support to state governments in the form of interest free loans of 50 year tenure subject to fulfillment of some pre-set conditions. In FY23, Centre disbursed Rs. 81,195 crores under this scheme to states. In FY24, Rs. 56,415 lakh crores has already been disbursed to 16 states this year, as against an allocation Rs. 1.3 lakh crores set out in the Budget. Approval has been given for a number of capital investment projects in sectors such as health, education, power, roads, railways etc. Table 4 gives state wise details of the same. Bihar has received the maximum allocation at Rs. 9,640 crores, followed by Madhya Pradesh at Rs. 7,850 crores and West Bengal at Rs. 7,523 crores.

Conclusion:

With private investment still nascent, government spending continues to be the major driver of growth. Given the known multiplier effect of capital expenditure, government has focused its attention on increasing its spending on growth and employment generating capital intensive projects. This is evident in a substantial increase in the Centre's capex spending in Q1FY24. An encouraging sign is a commensurate increase in state capex. While the picture diverges between states, the initial trends have been encouraging. To fund this, states have relied on increased market borrowings despite the higher costs. Apart from this, Centre is also providing assistance to state governments through interest free loans. Approvals under this scheme have already crossed 40% of the total allocation for this year, which also suggests there has been a substantial pickup in state capex. This bodes well for India's growth trajectory going forward.

Data Releases

Currency outlook

After depreciating to a record-low during the month, INR made a smart recovery to end the month only marginally lower. Pressure on the currency has come from worsening global backdrop of a strengthening dollar and elevated oil prices. RBI intervention helped the currency pair to limit losses. Unsurprisingly, INR was amongst the best performing Asian currency in Aug'23, despite a 1.7% increase in DXY. Elevated oil prices and a moderation in FPI inflows are likely to weigh on INR in the near-term. Fed rate trajectory will be contingent on incoming data and the US jobs report due later in the day will shed more light on the same. Against this backdrop, we expect INR to trade in the range of 82.5-83/$ in the next fortnight.

Bond Market Round-up

US 10Y yield has pared most of its increase in Aug'23 as major growth indicators remained patchy. Fed Chair's speech though remained hawkish, market is anticipating higher probability of a hawkish pause in the Sep'23 policy meet. Domestic 10Y yield remained stable. Some comfort came from slower pace of increase in high frequency data on prices in Aug'23 coupled with government's supply side measures. However, short end part of the curve reacted spontaneously to the underlying liquidity conditions. Mandate of incremental CRR together with monthly GST outgo have resulted in liquidity moving into deficit for the time this fiscal. We expect India's 10Y yield to remain in the range of 7.15-7.25% in the current month. Liquidity would continue to remain under pressure till RBI reviews the position on maintaining incremental CRR by banks. If RBI continues to extend the decision beyond 8th Sep, we might see some sell off in the short part of the curve.

GDP growth in Q1: India-fastest growing major economy

India's GDP rose by 7.8% in Q1FY24, following 6.1% growth in Q4FY23. While this was slightly lower than our estimate of 8-8.2%, India still remains the fastest growing major economy. Support to growth was provided by private consumption and investment. Government consumption and export growth weakened in Q1. Sector-wise, financial & real estate sector, trade, transport etc, and public administration and defence spending provided major boost to GDP in Q1. Agriculture growth softened and remains a key risk to overall GDP growth in FY24, as monsoon activity was lacklustre in Aug'23 (32% deficit so far). IMD expects a normal monsoon in Sep'23, which will be critical in determining overall growth trajectory in FY24. Going forward, we also believe that growth will get some support from government spending. We maintain our forecast of 6.3% growth for the full year (FY24)

Monsoon and Sowing: Update

India has been witnessing deficient rainfall in the month of August and it stands at 32% below LPA compared with a 13% (above LPA) surplus rainfall received back in July. Against this, for the cumulative period, rainfall is down by 8% below LPA (6% below LPA in the previous week) compared with a surplus of 7% (above LPA) for last year. Overall Kharif sowing has inched up marginally with much higher acreage in rice. However, pulses sown area continue to lag for the same period. Below normal rains has been witnessed in Central, Southern Peninsula and Eastern region. The impact of this scanty rainfall is likely to reflected though higher prices in the coming months.

Fiscal update

Centre's revenue position in FYTD24 (Apr-Jul'23) is seeing some moderation as its net revenue rose by 0.7%, softening from 3.6% increase Q1FY24. Gross tax collections have also slowed to 2.8% from 3.3%. This is largely on account of steady contraction in direct tax collections (-1.1% versus -1%) and slowdown in indirect tax collections (6.9% versus 7.8%). Non-tax revenue growth also eased (99.6% versus 149.3%). on the spending front, overall expenditure growth accelerated sharply to 22.5% from 10.8% as of Q1FY24. This was due to significant jump in revenue spending (15.9% versus -0.1%). Capex growth on the other hand slowed (52% versus 59.1%).

Core industries

Core sector growth in Jul'23 accelerated by 8%, slowing a tad from 8.3% increase in Jun'23. Moderation was mainly on account of slowing output in sectors like steel (13.5% in Jul'23 versus 20.8% in Jun'23), cement (7.1% versus 9.9%), and petroleum refinery products (3.6% versus 4.6%). On the other hand, output of coal rose in double-digits in Jul'23 (14.9% versus 9.8% in Jun'23) and that of crude oil (2.1% versus -0.6%), natural gas (8.9% versus 3.5%), and electricity (6.9% versus 4.2%) also improved.

CPI inflation

CPI inflation rose way more than our expectation of 5.8% to 7.44% in Jul'23 from 4.8% in May'23, on YoY basis. The upside surprise was on account of 702bps jump in food inflation, led by 37.3% jump in vegetable inflation from 0.9% decline in Jun'23, on YoY basis. Barring eggs and meat, all components of food noted sharp pickup. Double digit inflation is seen for cereals (13% in Jul'23 from 12.7% in Jun'23), pulses (13.3% from 10.5%) and spices (21.6% from 19.2%). For milk, inflation is still above the 6% mark, albeit some moderation.

Going forward, especially in Q2, considerable risks emanate from food inflation. Notably, even on a seasonally adjusted MoM basis, vegetable inflation firmed up by 30.5%. In Aug'23 as well (till 11 Aug), tomato, onion, edible oils, and pulses are inching up. Monsoon (cumulative till 14 Aug) is also 4% below LPA. With most part of sowing of pulses being over and sowing being comparatively lower, a near term spiralling of pulses cannot be ruled out. We do not see any respite for food for the remaining part of CY23, as cycles of vegetables are generally for 6-7 months and the fresh harvest also might be impacted due to weather vagaries and logistic issues.

Core CPI (excl. food and fuel) has moderated to 5%. Considerable drop was visible for clothing and footwear (5.6% in Jul'23 from 6.2% in Jun'23, on YoY basis). Other than that, housing (9bps drop), household goods and services (33bps drop) and education (37bps drop) showed moderation in its pace. It seems that pent up demand phenomenon has faded and actual transmission of rates into real economy has started shaping up.

The entire Q2FY24 and even the spillover to Q3 in terms of inflation expectation would keep the headline CPI trajectory on the upside. Our BoB CPI for Aug'23 is also showing 7.5% YoY increase.

WPI inflation

Headline WPI fell less than expected in Jul'23. It was down by (-) 1.4% versus our estimate of (-) 1.7% and (-) 4.1% in Jun'23. Food inflation surprised to reach to a 10-month high at 7.7% in Jul'23 after declining by (-) 1.2%

in Jun’23. Within food, most significant jump was noted in price index for vegetables (62.1% versus -22%), led by acceleration in prices of tomato (263% versus -55%), onion (7.1% versus -4.3%), okra (68.5% versus 37.2%), and brinjal (52.8% versus 27%). In addition, food grain inflation edged up tad bit (8.6% versus 8.5%), mainly due to paddy (9% versus 7.7%) and pulses (9.6% versus 9.2%).

Fuel and power inflation contracted further down to (-) 12.8% in Jul’23 from (-) 12.6% in Jun’23. In Jul’23, deflation in mineral oil index continued for the fourth consecutive month (-19.6% versus -19.5% in Jun’23). Within this, except for LPG, Petrol and furnace oil, prices declined for all other sub-categories. Amongst which, most significant drop in prices was seen in case of kerosene (-42.7% versus -33%), bitumen (-11.8 versus -7%) and ATF (-37.6% versus -34.4%). Under the major head of fuel and power, inflation index for coal registered an increase (5% versus 2.5%) while that for electricity cooled off to 0.1% from 0.6% in Jun’23.

Core inflation remains in deflation in Jul’23 as it fell to (-) 2.2% from (-) 2% in Jun’23. Manufactured products inflation declined at a slower pace to (-) 2.5% from (-) 2.7% in Jul’23. Of the 22 commodity sub-indices, 13 indices registered moderation in Jul’23 than Jun'23 led by paper products, tobacco, wood product, pharma, basic metals and other manufacturing. Inflation index for basic metals declined sharply (-6.1% versus -5.5%).

IIP growth

IIP growth came in lower than our expectations at 3.7%. We had a forecast of 5.5% which was based on support coming from the consumer goods segment to the impressive core sector performance.

Manufacturing growth was at 3.1% and brought down the overall growth rate. 14 of the 23 sectors in manufacturing registered negative growth. The significant non-performers were food, textile related and electronics amongst others. The performance of electronics is a disappointment as this industry had been a front runner for the PLI scheme. Machinery and metals were the drivers here.

In terms of the use-based industries, infra industries excelled with growth of 11.3% while consumer durables fell by 6.9%. FMCG grew by 1.2%. Clearly there is still stagnation in consumption. For the first quarter consumer goods have showed negative growth of 2.8%. Capital goods growth was just 2.2% and pushed up by machinery. However, there was flat growth virtually in ‘other transport equipment’.

For the quarter cumulative growth was 4.5% compared with 12.9% last year. In 2022, however growth was propped up by the base effect in 2021 when Lockdown-2 was imposed.

The third quarter will be crucial for the manufacturing sector as this would be the time when the festival demand would add to growth. Here both rural and urban demand would matter. Inflation has definitely come in the way of real purchasing power and while core inflation has been stable, food inflation has come in the way. It needs to be seen how growth in industry would perform in the coming months. Presently we are witnessing growth in only pockets which are related to infra push which is being given by the government.

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